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ABSTRACT

The Board of Governors of the Federal Reserve System and the Federal Reserve Banks administer more than two dozen regulations affecting a wide variety of financial activities. The regulations concern the functions of the central bank and its relationships with financial institutions, the activities of commercial banks and bank holding companies, and consumer credit transactions. In this booklet, brief explanations are given of the goals and scope of each of the 27 regulations. The regulations cover the following subjects: loans to member banks; equal credit opportunity; home mortgage disclosure; reserve requirements; purchase of warrants; securities of member banks; margin credit extended by parties other than banks, brokers, and dealers; membership requirements for state-chartered banks; member stock in Federal reserve banks; check collection and funds transfer; international banking corporations; interlocking bank relationships; foreign activities of member banks; relationships with foreign banks; loans to executive officers of member banks; member bank protection standards; interest on deposits; interlocking relationships between securities dealers and member banks; banking services performed for state-chartered banks; margin credit extended by brokers and dealers; margin credit extended by banks; guarantee of loans for national defense work; extensions of consumer credit; borrowers who obtain margin credit; bank holding companies; truth in lending; and consumer complaint procedures. (Author/AV)

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A Guide to Federal Reserve Regulations*

* This booklet is designed to give the reader a general overview of the regulations issued by the Board of Governors of the Federal Reserve System and is not intended to cover each regulation in detail or to explain all of their various provisions.

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Preface

The Board of Governors of the Federal Reserve System and the Federal Reserve Banks administer more than two dozen regulations affecting a wide variety of financial activities.

In broad terms, these regulations deal with the functions of the central bank and its relationships with financial institutions, the activities of commercial banks and bank holding companies, and consumer credit transactions.

These regulations are the Federal Reserve System's means of carrying out Congressional policies embodied in various banking laws and assigned to the System. For example, Congress passed laws during the 1930's to restrain the type of credit-financed speculation that contributed to the stock market crash of 1929. This legislation assigned to the System the task of controlling stock market credit. Regulations T and U were established to implement the law. Regulations G and X were implemented to deal with different aspects of the same problem.

A Guide to Federal Reserve Regulations, as its name implies, provides a general understanding of the goals and scope of the regulations. This booklet is neither a substitute for the regulations, a comprehensive summary, nor a substitute for interpretations of the regulations. For definitive answers to specific questions the regulations themselves should be consulted. Individual copies of the regulations can be obtained from the Board of Governors or from Federal Reserve Banks and their Branches. Pamphlets explaining consumer and margin regulations in more detail are also available.

BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551
(April 1978)

Text prepared by the Federal Reserve Bank of New York

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Regulations by Subject Matter

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Regulation A

Regulation A establishes the conditions and means by which Reserve Banks lend funds to member banks and others.

The regulation permits Reserve Banks to extend short-term adjustment, seasonal, and emergency credit to member banks and others. Credit extended to member banks usually takes the form of an advance on the bank's promissory note secured by U.S. Government and Federal agency securities, "eligible" commercial, agricultural or construction paper, or bankers' acceptances. Credit also may be extended to member banks secured by any other acceptable collateral at a higher rate of interest. Under certain circumstances, Reserve Banks may discount eligible notes or drafts endorsed by member banks. The regulation also permits Reserve Banks to make loans (collateralized by U.S. Government or agency securities), in emergency circumstances, to individuals, partnerships, and corporations for up to 90 days.

Regulation A requires Reserve Banks to make certain that credit they extend is not used for speculative purposes and that any paper offered as collateral is acceptable for discount or purchase under criteria specified in the regulation. Moreover, unless it has Board approval, a member bank cannot channel Federal Reserve credit to nonmember banks.

Regulation B

Regulation B prohibits creditors from discriminating against credit applicants, establishes guidelines for gathering and evaluating credit information, and requires written notification when credit is denied.

The regulation prohibits creditors from discriminating against applicants on the basis of age, race, color, religion, national origin, sex, marital status, or receipt of income from public assistance programs. As a general rule, creditors

may not ask on applications the race, color, religion, national origin, or sex of applicants. In addition, if the application is for individual, unsecured credit, the creditor may not ask the applicant's marital status. Exceptions apply in the case of residential mortgage applications, as noted below. Creditors also may not discriminate against applicants who exercise their rights under the Federal consumer credit laws.

Model credit application forms are provided in the regulation to facilitate compliance. By properly using these forms, creditors can be assured of being in compliance with the application requirements of the regulation. Creditors may use credit-scoring systems that allocate points or weights to key applicant characteristics. Creditors also may rely on their own judgment of an applicant's creditworthiness.

The regulation also requires creditors to give applicants a written notification of rejection of an application, a statement of the applicant's rights under the Equal Credit Opportunity Act, and a statement either of the reasons for the rejection or of the applicant's right to request the reasons. Creditors who furnish credit information must, when reporting information on married borrowers, report information in the names of each spouse.

The regulation establishes a special residential mortgage credit monitoring system for regulatory agencies by requiring that lenders ask residential mortgage applicants their race/national origin, sex, marital status, and age.

Regulation C

Regulation C requires depositary institutions making Federally related mortgage loans to make annual public disclosure of the locations of certain residential loans.

The regulation carries out the Home Mortgage Disclosure Act of 1975, which seeks to provide citizens and public officials with enough information to determine whether depositary institutions are fulfilling their obligations to meet the housing credit needs of their local communities.

The regulation applies to most commercial banks, savings banks, savings and loan associations, building and loan associations, homestead associations, and credit unions which make Federally related mortgage loans. These institutions must disclose annually the number and total principal amount of (a) residential first mortgage loans originated or purchased and (b) home improvement loans originated or purchased during the most recent fiscal year.

The Board of Governors is charged with writing regulations to carry out the Act, while enforcement is left to the appropriate Federal financial regulatory agencies. The Board may exempt from Regulation C any institutions complying with substantially similar State or municipal laws or regulations which have adequate provision for enforcement.

Regulation D

Regulation D defines the term deposit, specifies the amount of reserves member banks must maintain against deposits, establishes the method for computing reserve requirements and imposes penalties for reserve deficiences.

Required reserves are expressed as a percentage of balances a member bank has in each category of deposit. The highest percentage of reserves must be maintained against funds in depositors' checking accounts. Reserves are "lagged" so that they must be maintained for the current statement week (Thursday through Wednesday) against deposits held by the bank two weeks previously.

A member bank meets its reserve requirement primarily with a balance held at its Federal Reserve Bank, but may also use currency and coin held in its own vault for this purpose.

A member bank may carry an excess or deficiency of reserves of not more than 2 per cent of the required amount

into the following statement week. Further deficiencies are subject to a penalty.

Regulation E

Regulation E authorizes Reserve Banks to buy "acceptable" short-term obligations of State, county, and municipal governments, including those of drainage and reclamation districts. The regulation establishes "acceptability" criteria and limits the total amount of obligations Reserve Banks may purchase.

Reserve Banks may purchase bills, notes, revenue bonds, and warrants (all defined in the regulation as "warrants") issued by States, counties, political subdivisions, and municipalities in anticipation of taxes or revenues. The securities must be the issuer's general obligations and must mature in six months or less. The issuer must have been in existence for at least ten years and not have defaulted on the interest or principal of its debts during the previous ten years.

Unless permitted by the Board of Governors, Reserve Banks may not purchase and hold more than 25 per cent of the total outstanding warrants of a single issuer, or invest amounts exceeding ten per cent of its member banks' deposits in the warrants of all issuers. In addition, limits are placed upon the maximum amount of warrants that can be purchased by Reserve Banks depending upon the population of the issuing municipality.

Regulation F

Regulation F requires certain State-chartered member banks to register and file financial statements with the Board of Governors.

The regulation applies to State-chartered member banks that have 500 or more stockholders and at least $1 million in assets, or whose securities are registered on a national securities exchange. Generally, it does not apply to banks whose shares are owned by holding companies since these usually have fewer than 500 stockholders.

In general, these State-chartered member banks must file registration statements, periodic financial statements, proxy statements, statements of election contests, and various other disclosures of interest to investors. Officers, directors, and principal stockholders also must file reports on their holdings in the bank.

The regulation also prohibits tender offers for the stock of a bank subject to the regulation unless certain information is filed with the Board at the same time.

Regulations issued by the Board of Governors in this area are substantially similar to those issued by the Securities and Exchange Commission. Information filed under the provisions of Regulation F is available to the public at the offices of the Board of Governors in Washington, D.C.

Regulation G

Regulation G is one of four regulations concerning credit extended to finance securities transactions (see also Regulations T, U, and X). Regulation G governs credit secured by margin securities extended or arranged by parties other than banks, brokers, and dealers.

The regulation applies, with the exceptions noted, to any party who normally extends or arranges credit secured by margin securities of $100,000 or more in a calendar quarter, or who has credit outstanding to $500,000 or more during a quarter. These lenders must register with the Board of Governors within 30 days after the quarter ends.

Margin securities are those listed on national exchanges, securities convertible into margin securities, most mutual funds, and over-the-counter securities identified by the Board of Governors' Over-the-Counter (OTC) list. (The OTC

list published periodically by the Board is available from the Board or at Federal Reserve Banks.) The amount of credit a registered lender can extend or arrange for a securities transaction based on margin securities may not exceed the "maximum loan value" of the stock securing the credit. The maximum loan value of stock is a percentage of current market value fixed by the Board from time to time.

The regulation also includes special provisions covering loans to finance purchases of securities under stock option plans.

Regulation H defines the membership requirements and conditions for State-chartered banks, describes membership privileges and conditions imposed on these banks, explains financial reporting requirements, and sets out procedures for requesting approval to establish branches and for requesting voluntary withdrawal from membership.

State member banks are prohibited under the regulation from engaging in practices that are unsafe or unsound or that result in a violation of law, rule, or regulation.

The regulation also prohibits State-chartered member banks from making or renewing loans secured by improved real estate or mobile homes located or to be located in flood hazard areas not covered by the National Flood Insurance Program.

The regulation subjects State member banks issuing or renewing standby "letters of credit" or "ineligible acceptances" or other similar credit extensions to the ceilings the chartering State imposes on individual or total credit extensions and to the ceiling on loans to affiliates contained in Section 23A of the Federal Reserve Act.

Regulation H also requires State-chartered member banks acting as securities transfer agents to register with the Board of Governors.

Regulation I requires each bank joining the Federal Reserve System to subscribe to the stock of its District Reserve Bank in an amount equal to six per cent of the member bank's capital and surplus. Half the total must be paid on approval. The remainder is subject to call by the Board of Governors.

A six per cent dividend is paid on paid-in portions of Reserve Bank stock. The stock is not transferable and cannot be used as security.

Whenever a member bank increases or decreases its permanent capitalization, it must adjust its ownership of Reserve Bank stock to maintain a six per cent proportion. Payment for additional shares of Reserve Bank stock, cancellation of shares, as well as semi-annual dividend payments, are made through the member bank's reserve account.

A member bank's ownership of Federal Reserve stock is subject to cancellation on discontinuance of operations, insolvency, or voluntary liquidation, conversion to nonmember status through merger or acquisition, or voluntary or involuntary termination of membership.

Regulation J establishes procedures, duties and responsibilities among Federal Reserve Banks and (1) the senders and payors of checks and other cash items and noncash items, and (2) the originators and recipients of transfers of funds.

Regulation J provides for an orderly inter-bank system of collecting checks and other items and settling balances. It specifies terms and conditions under which Reserve Banks will receive items for collection from member banks and other depositors and under which Reserve Banks will present items to payors. The regulation also provides for an orderly inter-bank system of transferring funds on the

Federal Reserve Communications System. To this purpose, it specifies terms and conditions under which Reserve Banks will receive and deliver transfer of funds from and to member banks.

The Reserve Banks issue operating circulars, detailing the specific terms and conditions under which they will handle checks, cash and noncash items, and transfers of funds.

Regulation K

Regulation K governs the organization, capitalization, and operations of domestic corporations involved in international banking or finance.

Corporations organized to engage in international banking or other financial operations are chartered by the Board of Governors under Section 25(a) of the Federal Reserve Act. This section of the Act was introduced as an amendment in 1919 by Senator Walter E. Edge of New Jersey. Thus these corporations are known as "Edge Act Corporations."

The regulation permits Edge Act Corporations to engage in a broad range of international banking and financial activities, subject to supervision, while limiting transactions within the U.S. to those clearly international in character. It also imposes reserve requirements on certain deposits of these corporations.

Regulation L

Regulation L seeks to avoid restraints on competition between member banks and other banking institutions by restricting the relationships a director, officer, or employee of a member bank can have with other banking institutions.

The regulation prohibits directors, officers, and employees of member banks from being simultaneously a director, officer, or employee of another bank, banking association, savings bank or trust company organized under the National Banking Act or under the laws of any State or of the District of Columbia.

Exceptions are provided for situations where the institutions do not appear to be in competition. For example, a director, officer, or employee of a member bank can serve as a director, officer, or employee of an institution which is not located in the same, adjacent, or contiguous city, town, or village.

The regulation provides exceptions for certain other interlocking relationships, including those with banks in low income or economically depressed areas and banks controlled by minority groups.

Regulation M

Regulation M governs the foreign activities of member banks, including foreign branching, reserve requirements, and permissible foreign banking activities.

Member banks with capital stock and surplus of at least $1 million may establish a foreign branch with approval of the Board of Governors. After 30 days notice to the Board, additional branches may be established in foreign countries where a member bank has a branch. Operations of foreign branches are governed by the regulation.

With Board approval, a member bank may acquire and hold stock in foreign banks, providing the member bank has capital stock and surplus of at least $1 million and that the total investment in stocks of foreign banks and certain other subsidiaries does not exceed 25 per cent of capital and surplus. Certain other limitations are also imposed on investments in foreign bank stocks.

The regulation imposes reserve requirements on transactions undertaken by foreign branches with member banks and other U.S. residents.

Regulation N

Regulation N governs relationships and transactions among Reserve Banks and foreign banks, bankers, and governments and describes the role of the Board of Governors in these relationships and transactions.

The regulation gives to the Board the responsibility for approving in advance negotiations or agreements by Reserve Banks with any foreign banks, bankers, or governments. Reserve Banks must keep the Board fully advised of all foreign relationships, transactions, and agreements.

With Board approval, any Reserve Bank may open and maintain accounts for foreign banks or governments, or participate in accounts maintained by other Reserve Banks for foreign banks or governments. Accounts payable in foreign currencies may be opened and maintained by Reserve Banks on the books of Board-designated foreign banks.

Under direction of the Federal Open Market Committee, a Reserve Bank maintaining accounts with a foreign bank may undertake negotiations, agreements, or contracts to facilitate open market transactions. Reserve Banks must report to the Board at least quarterly on accounts they maintain with foreign banks.

Regulation O

Regulation O prohibits member banks from extending credit to their own executive officers, except as specified.

A member bank's loans to any one of its executive officers are limited to $45,000 allocated as follows:

- a maximum of $30,000 for the officer's residence;
- a maximum of $10,000 outstanding at any one time to finance the education of the officer's children; and
- an additional maximum of $5,000 for purposes not specified in the regulation.

All loans must be reported promptly to the member bank's board of directors. Loans must conform with the type the bank is authorized to make to all borrowers, and cannot have terms more favorable than those given other borrowers. The borrowing officer must submit a detailed financial statement to the member bank. In addition, the loans, at the option of the bank, become due and payable if the officer's outside bank borrowings exceed the limits on borrowings from the member bank.

A member bank officer must report to the bank's board of directors within 10 days after outside total bank borrowings in any of the three categories above exceed the amount that could be borrowed at the member bank.

Regulation P

Regulation P sets minimum standards for security devices and procedures State-chartered member banks must establish to discourage robberies, burglaries, and larcenies and to assist in identifying and apprehending persons who commit such acts.

A member bank must appoint a security officer to develop and administer a security program at least equal to the requirements of the regulation. The program must be in writing and approved by the bank's directors.

Each State-chartered member bank must annually file with its District Reserve Bank a signed statement certifying its compliance with the regulation.

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Regulation Q

Regulation Q defines the term deposit, establishes rules governing the withdrawal of savings deposits and the payment of time deposits before maturity, and establishes ceilings on the interest rates member banks pay on savings and time deposits.

Generally, the longer a depositor agrees to leave funds on deposit, the higher the rate of interest the bank is permitted to pay. Should a member bank allow withdrawal from a time deposit before the agreed-upon maturity of the deposit, the bank must impose an interest forfeiture penalty on the funds withdrawn as specified in the regulation.

The regulation also restates the statutory prohibition against the payment of interest on demand deposits contained in Section 19 of the Federal Reserve Act and prescribes rules governing the advertising of interest on deposits.

Regulation R

Regulation R aims at avoiding interlocking relationships between securities dealers and member banks, and, thus, any potential conflict of interest, collusion, or undue influence on member bank investment policies or investment advice to customers.

The regulation restates the general statutory prohibition on individuals involved in various phases of securities activities (including issuance, flotation, underwriting, public sale, or distribution) as either a director, officer, partner, or employee from serving simultaneously as a director, officer, or employee of a member bank.

However, the regulation permits member bank directors, officers, and employees to serve simultaneously as directors, officers, partners, or employees of organizations involved only in "government" securities transactions. These securities generally include, for example, those of the United States, the International Bank for Reconstruction and Development, the Tennessee Valley Authority, and the general obligations of States and municipalities.

Regulation S

Regulation S provides the means for the Board of Governors to regulate and examine banking services performed for State-chartered member banks by outsiders.

The regulation provides that both the State-chartered member bank and the outside party must make written assurances that services will be subject to regulation and examination just as if they were being performed at the bank.

Among the bank services performed under the regulation are check and deposit sorting and posting, and preparing and mailing checks, statements, and notes.

Regulation T

Regulation T governs credit extensions made in the course of business by securities brokers and dealers, including all members of national securities exchanges.

The regulation limits the amount of credit that may be extended to customers for purchasing or carrying securities based on the amount of cash and margin securities contained in the accounts. Generally, margin securities are those listed on national exchanges or identified as subject to margin requirements by the Board of Governors' Over-the-Counter stock list.

The maximum credit that may be extended to cover a purchase of margin securities—the "loan value"—is the percentage of their market value fixed from time to time by the Board. When securities on which credit has been extended are withdrawn from an account, cash or securities of an equivalent loan value usually must be deposited or a por-

tion of the account liquidated to the extent necessary to assure that the loan value of the account is not exceeded.

The regulation also prescribes rules governing cash transactions among brokers, dealers, their customers, and other brokers and dealers. It limits the concerns from which lending brokers and dealers may borrow in the ordinary course of their business.

Regulation U limits the amount of credit a bank may extend for purchasing and carrying margin securities if the credit is secured directly or indirectly by stock.

If a loan is to be secured, directly or indirectly, by any stock, a bank must obtain a properly completed Form U-1 in which the borrower must state the purpose of the loan. If the purpose is to purchase or carry any margin stock, the loan is a "purpose credit." Generally, if purpose credit is stock-secured, it is subject to the credit limitations and other restrictions of Regulation U.

Margin stocks include stocks listed on national exchanges, securities convertible into margin stocks, most mutual funds, and over-the-counter stocks listed on the Board of Governors' OTC list of securities subject to credit regulations.

At the time a purpose credit subject to Regulation U is extended, the amount of the loan may not exceed the "maximum loan value" of the securing stock. The maximum loan value of stock is a percentage of current market value fixed by the Board from time to time.

Regulation V facilitates and expedites the financing of contractors, subcontractors, and others involved in national defense work.

The Defense Production Act of 1950 and Executive Order 10480, as amended, authorize several Federal departments and agencies to guarantee loans by private financing institutions to contractors, subcontractors, and others involved in national defense work. Regulation V spells out the authority granted to Reserve Banks, as fiscal agents of the United States, to assist Federal departments and agencies in making and administering these guarantees. The regulation establishes procedures for processing these loan guarantees and sets maximum rates of interest, guarantee fees, and commitment fees.

Regulation W was revoked in 1952.

Regulation W prescribed minimum downpayments, maximum maturities and other terms applicable to extensions of consumer credit. Such action was authorized by Executive Order during World War II, and by Congressional legislation in 1947-1948 and again during the Korean conflict. With the repeal of authorizing legislation in 1952, Regulation W was revoked.

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Regulation X

Regulation X extends the provisions of Regulations G, T, and U (governing extensions of credit for purchasing or carrying securities in the United States) to certain borrowers and to certain types of credit extensions not specifically covered by those regulations.

The regulation applies to borrowers who, for purposes of purchasing or carrying securities, obtain credit in the United States and to borrowers who are "United States persons" or foreign persons controlled by, acting in behalf of or in conjunction with U.S. persons.

Regulation X requires that subject borrowers obtaining credit within the U.S. comply with Regulations G, T, or U—whichever applies to the lenders in the transaction. When credit is obtained outside the U.S., subject borrowers must comply as if the foreign lender were subject to Regulations G, T, or U.

Certain records must be kept by borrowers subject to Regulation X who obtain credit outside the U.S. that is secured in any manner by any security. These records must be substantially similar to those required by Federal Reserve Form X-1, and must be kept for six years after the credit is extinguished.

Aiding or abetting someone to violate the regulation is itself a violation.

Regulation Y

Regulation Y relates to the bank and nonbank expansion of bank holding companies and to the divestiture of impermissible nonbank interests.

Under the Bank Holding Company Act of 1956, as amended, a bank holding company is a company which directly or indirectly owns or controls a bank. The regulation contains presumptions and procedures the Board uses to determine whether a company controls a bank. The regulation also explains the procedures for obtaining Board approval to become a bank holding company and procedures to be followed by bank holding companies acquiring voting shares in banks or nonbank companies. The Board has specified in the regulation those nonbank activities that are closely related to banking and therefore permissible for bank holding companies. The regulation applies a separate test to activities that are permissible for foreign bank holding companies.

Regulation Z

Regulation Z prescribes uniform methods of computing the cost of credit, disclosure of credit terms and lease terms, and procedures for resolving billing errors on certain credit accounts.

The credit provisions of the regulation apply to all persons who, in the ordinary course of business, regularly extend or offer to extend, arrange or offer to arrange consumer credit. Consumer credit is generally defined as credit offered or extended to individuals for personal, family, household, or agricultural purposes.

The major provisions of the regulation require lenders to:

- provide borrowers with meaningful, written information on the cost of credit in terms of both the finance charge and the annual percentage rate.
- respond to consumer complaints of billing errors on certain credit accounts within a specific period.
- identify credit transactions on periodic statements of open end credit accounts.
- make sufficient disclosure of personal property leasing terms to enable consumers to compare leasing and purchasing costs, and limit end-term liability on certain leases.
- provide certain rights regarding credit cards.
- inform customers of the right to rescind cer-

tain real property transactions within a specified period.

- comply with special requirements when advertising credit.

Regulation AA establishes consumer complaint procedures.

Under the regulation, any consumer complaint about an alleged unfair or deceptive act or practice by a State member bank, or an alleged violation of law or regulation, will be investigated. Complaints should be submitted, preferably in writing, to the Director of the Division of Consumer Affairs at the Board of Governors of the Federal Reserve System, Washington, D.C. 20551; or to the Reserve Bank for the District in which the institution is located.

The complaint should describe the practice or action objected to and should give the names and addresses of the bank concerned and the person complaining.

The Board will attempt to give a substantive reply within 15 business days, or, if that is not possible, will acknowledge the complaint within 15 business days and set a reasonable time for a substantive reply.

The Board will also receive complaints regarding institutions other than State member banks. Complaints about State-chartered member banks are handled by the Federal Reserve, and complaints about other institutions will be referred to the appropriate Federal agencies.

A person filing a complaint does not have to be a customer of the institution in question, and the acts or practices complained of do not have to be subject to Federal regulation. Consumers may complain about acts or practices that may, in fact, be expressly authorized, or not prohibited, by a current Federal or State law or regulation.